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ENVIRONMENT AND SUSTAINABLE DEVELOPMENT

Letter dated 19 November 1996 from the Permanent Representatives of Denmark and South Africa to the United Nations addressed to the Secretary-General

The Workshop on Financial Mechanisms and Sources of Finance for Sustainable Forestry, held in South Africa, 4-7 June 1996, as one of the inter-sessional meetings in support of the Ad Hoc Intergovernmental Panel on Forests (IPF) was co-sponsored by UNDP and the Governments of South Africa and of Denmark. The arrangement and its outcome were a success, resulting in a substantive declaration and final report.

The purpose of the workshop was to contribute to the very important work being undertaken by IPF in terms of its mandate for the Commission on Sustainable Development. South Africa and Denmark consider the issue to be of vital importance. The forestry workshop proceedings are central for the continued involvement of IPF in the preparations for the session of the Commission in April 1997 and the special session of the General Assembly in June 1997, for the purpose of an overall review and appraisal of the implementation of Agenda 21.

We respectfully request you to include this letter and the declaration and the report annexed below as a document of the General Assembly under the appropriate agenda item.

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Annex

REPORT OF THE WORKSHOP ON FINANCIAL MECHANISMS AND SOURCES OF FINANCE FOR SUSTAINABLE FORESTRY

PREAMBLE

The Workshop was held to support and contribute to the work of the Ad Hoc Intergovernmental Panel on Forests (IPF) of the Commission on Sustainable Development in its programme element II: international cooperation in financial assistance and technology transfer for sustainable forest management. Seventy experts from 45 countries met in Pretoria, South Africa, to analyse and discuss financing for sustainable forestry. They acted in their personal capacities, and this text reflects their views as experts. Participants came from Governments, the private sector, non-governmental and international organizations.

Meeting future human needs in the areas of food, water resources, energy and human settlements depends crucially on how the world's forests are managed. World demands for both traditional and non-traditional forest products are rising rapidly. So are demands for the whole range of environmental services provided by forests, not only local services such as water storage, erosion control and soil protection, but also global services such as biodiversity and carbon storage. With annual deforestation running at around 16 m ha, supply is falling. Shortages will become increasingly probable, resulting in higher average prices for forest products and services, and more substitutes for wood. Plantation forests will provide for some demands, albeit at social and environmental costs and benefits not yet fully reckoned.

Adequate financing is necessary for a host of forest-sector activities, public and private, domestic and international. Most of financing in forestry will come from domestic sources. Official development assistance (ODA) is particularly important in developing countries as it provides crucial support for building capacity and catalysing other sources of finance. It is especially critical in less developed countries where a much greater level of support may be necessary to achieve sustainable forest management.

Commonly cited factors causing deforestation range from logging to fuelwood collection and to land conversion for crops and grazing. Behind these, however, lie other and deeper causes such as poverty among marginalized populations who live in forests or on the fringes of forests, and depend on them, but derive few, if any benefits, from their unsustainable exploitation. Governments need urgently to empower these people by granting them secure tenure and access to land and decision-making about its use. Sustainable forest management will depend on comprehensive sustainable development, especially sustainable agriculture and food security and alleviation of poverty.

Worldwide there is a depletion of forest capital due to deforestation and forest degradation. This is a global phenomenon occurring both in tropical, temperate and boreal forests. Developing countries are attracting gross investment of about US$ 20 billion from domestic and foreign sources. At the

same time, however, they are suffering a disinvestment [or depreciation of forest capital] estimated roughly at about US$ 45 billion, as a result of deforestation. This results in a net negative investment of about US$ 25 billion annually. This huge investment gap will continue to expand without major changes in policy and regulatory regimes.

During the past few years many donors have reduced ODA and forestry ODA has declined in real terms. These trends should be reversed. Moreover, forestry ODA goes to relatively few countries among those that required such assistance. A promising new emphasis is a shift in forestry ODA from traditional to sustainable forestry, rural development and conservation. Both socio-economic and environmental benefits of forestry justify an increase in the sector's share of ODA which now stands at only 3 per cent of the total. Domestic funding for forestry has risen substantially in several developing countries.

Meanwhile, private investment flows to developing countries have been rising and are now five times greater than ODA. One critical task is to direct private investment towards sustainable forest management. Sustainable forest management can provide an efficient, effective and least-cost alternative when social and environmental benefits are included in the economic equation. In developing countries the current flows of private investment are highly concentrated on a few countries with export potential, while serious shortages of funds are experienced in countries where forestry is oriented towards domestic markets.

It was recognized that vast areas of forests are not being managed sustainably but there are several promising trends towards sustainability. First, the effective participation of local populations in decision-making is becoming common facilitating achieving sustainability. Secondly, several forest operations are now generally recognized as being sustainable. Thirdly, investment in industries based on sustainable forest management, such as tourism and non-wood forest products, are large and growing rapidly. It is also recognized that private sector activities in sustainable forestry in most countries can and should be self-financing even though it often requires substantial initial investment which justifies support by public spending and international assistance. With the reform of the policy and regulatory frameworks within which it operates, sustainable forest management should generate net revenues. There is however a great diversity between countries, and many nations are in need of significant external assistance to manage their forests sustainably.

INVESTMENT AND FINANCING

Basic considerations

To attract investment in sustainable forestry, political and macroeconomic stability is necessary. Access to land and the security of property rights are also fundamental. Governments have major responsibility to create an enabling environment for investment including:

(a) An effective and appropriate regulatory framework;

(b) A clearly defined forest policy, which is not in conflict with other sectoral policies, as well as policies which promote effective finance;

(c) Transparent, participatory and democratic decision-making processes;

(d) Capacity-building in key areas;

(e) Non-conventional financial intermediaries that provide financial services to small farmers.

It is recognized that there is no alternative to domestic policies which ensure efficient and environmentally sound use of resources and which are backed by the political will and public service capacity to deliver them.

Undervaluation

Forests are often assigned very low or no market value. This contributes to wasteful utilization and acts as a great disincentive to investment. Undervaluation and accounting distortions result in uncompensated transfers of forest land to other uses.

National economic accounting systems currently harbour a fundamental error. They have no capital accounts and hence ignore changes in the value and stocks of resources. Consequently, it is possible to show high levels of national or corporate income by running down resource stocks even when this is sure to bring declining incomes in the future. National accounting systems also fail to place a value on, or they undervalue, the economic services provided by natural resources. Forests, for example, provide habitat for species and means to retain water and soils, the loss of which carries costs associated with reduced crop yields and flooding. These systems need urgently to be revised and reform efforts, which are now under way, should be supported, recognizing the long-term nature of the task. Each country will develop these according to their needs.

Actors

Sustainable forest management will require support to a variety of institutions. Among the most essential are:

(a) Public agencies to enforce norms and regulations equitably;

(b) Private enterprises with operations based on sustainable forestry;

(c) Community-based organizations which represent, mobilize and empower local people;

(d) Institutions for research and technology dissemination on sustainable resource use.

Incentives

The forest industry in many countries is provided with a wide variety of incentives and subsidies. In granting fiscal incentives such as tax breaks, and

stumpage fees and rents set well below market value, Governments are short-changing themselves and their taxpayers, and they encourage industry to engage in unsustainable practices for short-term gain. Governments should give high priority to a review of their incentive systems with a view to reforms that will encourage sustainable forest management.

Many benefits of sustainable forest management are in the form of externalities such as conservation of biodiversity, protection of watersheds and carbon storage, which currently are not priced by the market. There is therefore a need to establish a policy and regulatory framework within which these externalities are priced.

The social dimensions of sustainable forest management may require substantial initial investment which justifies public support and international assistance. Extreme care is necessary in designing and implementing an incentive system to promote sustainable forest management to avoid subsidizing unsustainable practices.

A sustainable and commercially viable forest industry should also include the production of non-traditional forest products and the expansion of markets for them. This will benefit the poor and often marginalized people whose livelihood depends on forests.

Innovative financing for sustainable forestry development

Innovative financial mechanisms are promising and their applicability varies greatly between countries. While Government and other stakeholders have been dedicating resources to the development of new financial instruments to address sustainable forestry, the huge shifts in global capital markets over the last five years suggest that the main issue for capturing private sector funding for forest management is not developing new financial instruments, but linking existing investment flows more directly to sustainability and with sustainable forest management in particular.

Several innovative international public finance mechanisms have been proposed and discussed in international forums over the last few years to augment current financing of multilateral institutions. Many international activities produce global and national benefits, such as peacekeeping, administration of justice, sustainable forest management, trade and transport, and communication channels, as well as emergency relief, etc., and many global and national resources need protection such as the ocean, forests, the atmosphere, and the ozone layer. A benefit of international public finance would be that it is "automative" as opposed to voluntary as current ODA funding is. The various instruments proposed can be divided into three groups: international taxes; user charges for global commons; and monetary measures. The Expert Group on Finance and Consumption has recently produced much useful analysis and documentation on this topic. This is being considered by the Commission on Sustainable Development and IPF's recommendation should be consistent with that of the Expert Group.

Domestic public financing is clearly very important for sustainable forest management because of the many national benefits. Innovative mechanisms of

mobilizing this have had substantial success in several developing countries since the United Nations Conference on Environment and Development. Sources included under both forest products and services include: budget transfers, special funds, phasing out subsidies, objective-oriented taxation, beneficiary taxes, watershed charges, full cost pricing, deforestation charges/taxes, and reforestation and/or forest management bonds etc.

A critical factor in moving new capital into sustainable forestry will be to convert the development framework provided by national forestry programmes into an investment framework within sectoral investment programmes.

Private capital flows into the forestry sector in developing countries, while difficult to measure, are already in the billions each year representing an opportunity for channelling investment to sustainable forestry but they are also a threat to forestry if business as usual continues.

The public sector and private capital markets will need to work together in new ways to close the funding gap. Options for action to address the needs of sustainable forestry development include: (a) utilizing established financing approaches that have already been proven; and (b) focus on high leverage use of public funds. Creating entirely new financing mechanisms adds another element of risk in the emerging sustainable forestry sector and their development needs careful preparations, testing and evaluation.

In countries which want to establish links to capital markets and to channel capital into the new area of sustainable forestry investment it will require the creation of capital markets infrastructure. "Value chain investing" (forestry-primary and secondary processing-distribution) is another option because it lowers risks and creates cost savings. Public funds can be used to offset risks related to market development, and to compensate the costs of incorporating externalities into business operations, and the incremental management costs of moving capital into the new area of sustainable forestry.

There is a critical need for equity and debt funding instruments which lower the overall risk of sustainable forestry investment. The types of funds needed include: (a) small and medium-scale early-stage venture funds to help move capital, inject business rigour and attract management talent to sustainable forest management; and (b) medium-to-large-scale sector-specific funds to help the professional investment community to identify that sustainable forest management is ready for mainstream investment.

The Workshop considered many examples of new ways to move capital towards sustainable forestry and related areas which offer potential for replication and they should continue to be monitored, analysed, and promoted to investors, bankers, insurers etc.

COORDINATION

Coordination in financing sustainable forestry is an important tool to improve effectiveness and efficiency in fund-raising and utilization, but it

should not be an end in itself. Poor coordination of funding often results in waste or gross misuse of vital resources.

Coordination needs to be addressed both at national, regional and global level, and it should include all the stakeholders, including the private sector.

In-country coordination

The responsibility for in-country coordination should be with the Government. Effective coordination requires strong political leadership, planning bodies with adequate capacity and finance, a qualified and responsive planning capacity, and a consensus-building process where all stakeholders should participate and be provided with the necessary information.

National forestry programmes should be established as country-driven processes and the framework for coordination of financing and international cooperation.

For in-country donor coordination the Government may entrust a supporting role to an external agency with a long-term commitment to the sector. Pooling of resources is an option to improve efficiency.

International-level coordination

Governments, international organizations, and donor communities should have a shared vision of sustainable forest management, providing common objectives and a basis for coordination. Governments should direct their delegations to international agencies to take consistent positions on sustainable forest management and they should ensure that their bilateral agencies support these positions.

International coordination of development financing for sustainable forest management should focus on eliminating duplication, competition and support country-driven programmes. It should focus on providing a better flow of synthesized information on programme progress, policy development, best practices and lending strategies. This would help to avoid repetition of past failures and allow fast transfer of knowledge on successful pilot projects and evaluation of lessons learned.

The national forestry programme should be used by donors to plan their programmes in recipient countries and they should encourage a shift from individual projects to programmes.

Donor coordination should begin with internal consistency.

Appropriate indicators should be defined for monitoring and evaluation of the effectiveness of international cooperation.

Partnerships should be forged between Governments, local stakeholders and sources of external funds. The feasibility of forest partnership agreements should be established through further study and national experiments.

Coordination (in-country and international level) between intergovernmental organizations within the United Nations system should be mandatory, with formal arrangements put in place for this purpose.

Informal coordination mechanisms such as the Forestry Advisers Group and those of non-governmental organizations should be encouraged.

Coordination and the private sector

Participation of the private sector in national forest policy and planning processes is an important element for coordination.

The international private sector engaged in forestry activities already has sophisticated mechanisms of coordination including those aimed at the highest levels of Governments. This is achieved through direct contact, trade missions, etc. It is essential that Governments involve representatives of forest and environment agencies in these endeavours, missions etc. to ensure that resulting investment flows support sustainable forest management.

National Governments need to send the right signals to mobilize private capital and to maximize public benefits from private investment. Mechanisms include a predictable investment climate, enforceable but fair environmental regulations, secure resource tenure, development of capital markets, creation of information clearing house services, dissemination of information on innovative investment arrangements, establishment of revolving funds for pre-investment studies and inventories, etc.

Public-private partnerships should be employed as a means both to lever limited public funds, including ODA, and to channel larger investments into sustainable forest management.

PRETORIA DECLARATION

Seventy experts from 45 countries from all regions met in the Workshop on Financial Mechanisms and Sources of Finance for Sustainable Forestry, co-sponsored by the Governments of Denmark and South Africa and by UNDP, held in support of IPF, from 4 to 7 June 1996, in Pretoria.

The experts recognized that forests including wooded lands, simultaneously provide a wide range of economic, social, environmental and cultural benefits at the local, national, regional and global levels, and that maintaining all types of the world's forests in a healthy state is in the collective interest of the present and future generations.

The experts however expressed deep concern about the lack of follow-up and implementation of the Rio agreements in order to combat deforestation and to promote sustainable forest management, and concern in particular:

(a) That forests worldwide are not being managed sustainably, and that extensive unplanned deforestation and forest degradation is taking place at an unprecedented rate;

(b) About the ability of forests to meet the multiple needs of societies if the current trends and investment practices continue;

(c) The resource gap to meet the needs of sustainable forest management.

In order to address these concerns and to reach the goal of economically efficient, socially balanced and ecologically sound sustainable forest management, the experts call upon the Governments, private sector and investment community, multilateral international organizations, non-governmental organizations and the voluntary sector to recognize their shared responsibility and to take urgent action as follows:

(a) National Governments undertake policy reform that includes securing market value of the natural resources capital stock, land-use planning and security of land tenure, as well as the use of domestic resources;

(b) National Governments create and promote a favourable environment for investment in sustainable forest management including macroeconomic stability as well as develop and maintain strong institutional and human capacity;

(c) National Governments provide incentives and promote the use of appropriate technologies to support sustainable forest management, particularly to small enterprises, local communities, and forest owners as well as ensure that incentives to other sectors are supportive of sustainable forest management;

(d) National Governments formulate and implement, through an open and participatory process, a national forest programme that includes clear action plans and provisions for in-country coordinating mechanisms and monitoring of

progress and that ensures consistency in national development planning as well as macro and relevant sectoral level;

(e) The donors and the voluntary sector particularly focus their activities in meeting subsistence needs, building capacity and creating potential industrial opportunities in developing countries, particularly those with low forest cover;

(f) The share of domestic financial resources as well as the share of ODA allocated to sustainable forest management activities be increased in real terms, especially the recognition of the latter's critical role in financing sustainable forest management in many developing countries;

(g) Mobilization of additional domestic and external financial resources to fund the necessary measures for promoting sustainable forest management;

(h) New financial mechanisms to mutually leverage private investment and ODA funds need to be developed;

(i) More efficient use of funds from all sources;

(j) The donors should respond to the priorities of the developing countries and improve their efficiency and effectiveness through allocation of higher proportions of total funds to local implementation, coordination and periodic joint evaluation;

(k) Private sector should be encouraged to adopt codes of conduct to promote sustainable forest management;

(l) The United Nations system should agree to mandatory coordination; the roles of United Nations agencies need to be clearly defined and based on their comparative strength to implement a shared vision of sustainable forest management;

(m) Increase support for research to promote sustainable forest management.